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No Implied Duties When Voting to Discharge an Operator

By: Nigel Bankes

Case Commented On: *TAQA Bratani Ltd et al v RockRose UKCS8 LLC,* [2020] EWHC 58 (Comm)

The operator serves a crucial role in the operation of any jointly owned oil and gas property and yet, depending on the terms of the joint operating agreement (JOA), it may be quite difficult to remove and replace an operator. In this decision of the Commercial Division of the High Court (England and Wales), Judge Pelling QC sitting as a judge of the High Court concluded that a group of dissentient joint operators (TAQA, JX and Spirit) (the claimants) were entitled to use a unanimous voting provision in the JOA to replace Marathon oil (MOUK) (acquired by RockRose (RRUK) effective 1 July 2019). Furthermore, there were no implied conditions that the claimants had to fulfill before they could exercise this power. Accordingly, Judge Pelling granted the claimants the declaration that they sought to the effect that the notices by which they purported to terminate the operatorships of various JOAs pertaining to the Brae Fields in the North Sea were valid and take effect in accordance with their terms.

The JOAs in question provided for the discharge of the operator in one of three ways: (1) discharge on at least 90 days notice by unanimous vote of the operating committee (ignoring the vote of the incumbent operator), (2) "forthwith" and upon notice of the operating committee for cause (e.g. insolvency), and (3) upon resignation of the operator. In this case the claimants relied on the first option. The Court ruled that this provision conferred (at para 34) "an unqualified right to terminate the Operator role." This was consistent with the provisions in the JOA emphasizing that the joint venture between the parties was not a partnership and that the parties were entitled to vote at meetings of the operating committee in accordance with their own interests. As Judge Pelling put it:

> The relationship was one that ultimately depended on the interests of the parties to it being aligned. Where that ceased to be so the parties were free to act what they perceived to be in their respective individual best interests. There is nothing within the JOAs that creates for MOUK a vested right to continue as Operator that it is entitled to maintain other than with the consent of the other parties to the relevant JOA. (at para 38)

That was actually enough to decide the case since Judge Pelling was of the view that the language of the contract was clear. However, Judge Pelling went on to consider RRUK's arguments to the effect that the discharge provisions were actually qualified by either "(i) an implied term that qualifies the manner in which it may be exercised by concepts of good faith, and genuineness and the absence of arbitrariness, capriciousness, perversity and irrationality … and/or (ii) qualifications to similar effect arising from the mutual trust, confidence and loyalty

said to arise in long term joint venture and similar agreements …" (at para 30). But any argument based on an implied term was clearly challenging given Judge Pelling's conclusions as to the meaning and effect of the JOA. As he noted:

> … it is difficult to see how terms to that effect could be implied into the agreement. That is so because it is not necessary to imply any of the terms for which RRUK contends either in order to give business efficacy to the JOAs or in order to give effect to what was so obvious that it went without saying. The contract permits an Operator to continue as such only with the consent of the other parties to the JOAs. The terms RRUK seeks to imply are not necessary in order to deliver on that model and the express terms on which the claimants rely are inconsistent with the proposed implied terms. (at para 45)

In case he was wrong on all of this, Judge Pelling also went on to examine whether there was any basis for suggesting that the claimants or any of them may have voted to discharge MOUK for a reason that was somehow improper. He found no evidence to substantiate this. Instead, he found all sorts of reasons to support the view that each of the claimants was motivated by its own commercial considerations. TAQA was interested in displacing MOUK as the operator so as to realize economies of scale associated with operating the Brae Fields together with its other North Sea fields – particularly the costs of decommissioning these facilities as they moved to the end of their lives. TAQA was also motivated by safety, operational and financial risk concerns associated with RRUK's stepping into the shoes of MOUK on the grounds that RRUK was small and lacked any operational experience. These latter concerns were also shared by JX and Spirit. JX in particular was concerned to have the most experienced party as operator. Judge Pelling found that it was permissible for each of the parties to act in their individual self-interests. There was no duty of loyalty to the other parties or to the enterprise of the joint venture.

As part of the agreement between the claimants to oust MOUK as operator and replace it with TAQA, TAQA agreed to cap the transition costs (i.e. the costs to the joint venture of transitioning TAQA into the operatorship) of JX and Spirit at their share of £5 million. There was nothing improper about such an arrangement:

> There is no reason why, as between two or more participants, there should not be a local agreement between them for the sharing between them of some or all of the costs otherwise due under the terms of the JOA from one or both of them. Such an agreement could have no impact on the primary obligations of each of the parties under the JOA, which could only be altered by variation or novation of the relevant JOA. The effect of the agreement was not to increase to any extent the financial burden on MOUK/RRUK. There is no basis for suggesting that any such agreement would be improper unless the same terms were offered to each of the other joint venturers. Their respective rights and obligations are governed by the JOA. What each agrees with the other outside the JOA is immaterial at least where as here it has been agreed that the JOA does not constitute a partnership or similar relationship. (at para 114)

There was some attempt by RRUK to characterize the claimants as having acted improperly by failing to take account of the risk that a change of operatorship might trigger immediate payment by the joint venture parties of a significant pension deficit. (For the back story on that see the

earlier decision of the English Court of Appeal in *Spirit Energy Resources et al Marathon Oil UK LLC*, [2019] EWCA Civ 11 and my comment on that decision here). That argument failed since the evidence did not support the conclusion that there would be a significant acceleration or that the change of operatorship (as opposed to loss of MOUK's parent guarantee) would be the proximate cause of that acceleration.

Finally there was also apparently some effort to establish a custom in the industry to the effect that the right to discharge on notice was qualified in some way, but Judge Pelling ruled that the evidence fell far short of establishing such a practice (at para 42).

It is useful to reflect on how this case would have been argued in a Canadian context. If this fact pattern were to arise on the same terms in Canada, RRUK would undoubtedly seek to frame its case on the basis of *Bhasin v Hrynew and Can-Am*, 2014 SCC 71. That decision also involved the exercise of a power – in that case the exercise of a power by Can-Am not to automatically renew a retailer dealership agreement between itself and Bhasin.

In its decision the Supreme Court recognized "an organizing principle [in Canadian law] of good faith that underlies and manifests itself in various more specific doctrines governing contractual performance" (at para 63). The principle requires that "parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily" (ibid). The Court further explained:

> The organizing principle of good faith exemplifies the notion that, in carrying out his or her own performance of the contract, a contracting party should have appropriate regard to the legitimate contractual interests of the contracting partner. While "appropriate regard" for the other party's interests will vary depending on the context of the contractual relationship, it does not require acting to serve those interests in all cases. It merely requires that a party not seek to undermine those interests in bad faith. This general principle has strong conceptual differences from the much higher obligations of a fiduciary. Unlike fiduciary duties, good faith performance does not engage duties of loyalty to the other contracting party or a duty to put the interests of the other contracting party first. (at para 65)

Finally, the Court observed (at para 70) that "The principle of good faith must be applied in a manner that is consistent with the fundamental commitments of the common law of contract which generally places great weight on the freedom of contracting parties to pursue their individual self-interest. In commerce, a party may sometimes cause loss to another — even intentionally — in the legitimate pursuit of economic self-interest …" (references omitted).

In sum, I think it is fairly clear that a case on these facts and contractual provisions would be decided the same way in Canada. While the JOA may be a long-term relational contract rather than a transactional contract, and while RRUK as the operator may be vulnerable to the exercise of a power by the other working interest owners, none of this requires those working interest owners to put aside their individual self-interest (see also *Bhasin* at para 86). There is nothing in any of the facts here to suggest that any of TAQA, JX or Spirit acted capriciously, arbitrarily or in bad faith.

The Court in *Bhasin* also articulated (at para 73) a new general duty of honesty in contractual performance: "This means simply that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract." This is a general duty of contract law rather than an implied term. This articulation of a new duty was material in the *Bhasin* case because of the trial court's conclusion that Can-Am had been dishonest in its dealings with Bhasin and was effectively electing not to renew the agreement in order to favour Hyrnew (a competitor of Bhasin's); but there is no suggestion in *TAQA v RockRose* of any dishonesty on the part of TAQA, JX or Spirit, merely the protection of their own individual self-interests.

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